IN THE

Supreme Court of the United States

October Term, 1956

No. 988

ESSER, RAU & HOFFMAN and JACK L. RAU, individually,

Petitioners,

vs.

GEORGE T. GOUGIN, Trustee in Bankruptcy of Stockholders Publishing Company, Inc., a bankrupt,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

REPLY BRIEF OF PETITIONER.

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The brief filed on behalf of Respondent does not meet or substantially answer the position of Petitioners on their application for the Writ of Certiorari. There are, however, a few assertions and contention in Respondent's brief which need reply and correction.

In Respondent's statement of the question presented for review (Resp. Br. p. 1) he includes, in speaking of the firm of attorneys who seek to set-off a claim for out-of-pocket expenditures, the statement that one of such firm "is an officer and director of the corporation." The inclusion of this language in Respondent's framing of the

question presented is, for the obvious purpose of laying a foundation for that portion of Respondent's argument devoted to the irrelevant proposition that a director of an insolvent corporation is a trustee for creditors, as well as for the corporation, and will not be allowed "to use his position, with superior knowledge or opportunity of acquiring information which it affords, to secure an advantage for himself over other creditors." (Resp. Br. p. 6.) All of this, of course, has nothing to do with the case at bar. Petitioners are not seeking, and have never sought, to take any advantage or to avail themselves of any knowledge which came to one of the members of the petitioning firm as a director of the bankrupt. They did not deduct or attempt to deduct the amount of their claim, even though they knew that the publishing company was unable to meet its obligations. Had they done so, then, and only then, would they have come within the rule upon which Respondent bases his contention. On the contrary, they waited until after bankruptcy and then presented a petition for leave to set off their claim as against the amount owing to their erstwhile client, like any other outside party possessing no forewarning or information.

Respondent contends, hypothetically (Resp. Br. p. 6), that "*if* petitioners had made any payments to themselves from the special account, it would have been a breach of fiduciary duty." This argument is an idle one because petitioners did not assume to make any such payment. It is similarly futile to contend that *if* such a payment had been made, *it would have been* voidable as an unlawful preference.

The sharp question before the courts below and before this Court is whether or not the respective and admitted claims present a case of mutual debts or mutual credits under Section 68(a) of the Bankruptcy Act.

Respondent contends that the Court of Appeals successfully distinguished the present case from *Half Moon Fruit & Products Co. v. Floyd*, 60 F. 2d 709, upon the ground that Petitioners "could not have asserted any lien against the money in the trust account," and upon the ground that "the law firm had no beneficial interest in the trust account." In the first place, Petitioners do not seek to assert a lien nor do they predicate their claim upon the existence of a lien. In the second place, as pointed out in the Petition for the Writ at page 9, the Court of Appeals failed to note that the counterclaimant in the *Half Moon* case had forfeited his lien and was, therefore, held to have no claim on such basis. Furthermore, the Court of Appeals did not place its attempted distinction on the ground that petitioners had no beneficial interest in the trust account, although the opinion does state that the commission merchant in the *Half Moon* case had some kind of "a qualified property right in the res," whatever this means. If petitioners had possessed a lien, or beneficial interest or property right in the fund, they would not present or be obliged to present their claim by way of set off, which is based upon an independent or separate obligation and which concedes the existence of the claim of the other party.

It is believed that the court in *Western Fuel and Timber Co. v. Brown*, 196 U. S. 502, did not ground its opinion

upon the fact that the Tie Company was in the position of a trustee, as is contended by Respondent. (Resp. Br. p. 5.). Ratner, the court predicated its opinion upon the fact that the established course of dealing between Harrison, the bankrupt, and the Tie Company, was that the Tie Company invariably remitted in full money collected from its employees which they owed to Harrison without regard to any indebtedness of Harrison to the Tie Company. Moreover, the court said that the findings established "that Harrison sold the goods, not to the Tie Company, but to the laborers, and, therefore, the result of the sale was to create an indebtedness for the price *alone* between Harrison and the employees." (Italics supplied.)

Respondent has completely failed to recognize or to explain away the decisions called to this Court's attention in the petition herein (pp. 9-13), contenting himself, doubtless, with the inadequate treatment of the subject by the Court below in the language, "It is not our problem to here catalogue the cases where setoff is allowed," because "where it is allowed * * * the creditor must already have some beneficial interest of his own in or against the subject property * * *." If this the Court was in error. The authorities do not justify such conclusion.

Neither does the Respondent discuss the effect of Rule 13 of the Rules of Civil Procedure, again probably relying upon the assertion by the Court of Appeals that "this procedural rule would (not) grant a substantive right which did not otherwise exist." Petitioners' basic substantive right was a valid claim to reimbursement for out-

of-pocket expenditures, and the right of set-off in bankruptcy as against funds properly in claimants' hands was a procedural opportunity already afforded by Section 68(a) of the Bankruptcy Act.

If a graph of the decisions were drawn it is believed that it would show a rising tendency to allow set-offs and counterclaims in situations such as is presented in the instant case.

Again it is urged that the petition for the Writ of Certiorari be allowed.

Respectfully submitted,

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